

August 2007, Number 163

## POTENTIAL IMPACT OF THE GREAT PLAN ON GEORGIA'S TAX ADMINISTRATION

Georgia's Speaker of the House of Representatives has proposed a sweeping tax reform: The GREAT Plan for Georgia. The plan proposes elimination of all property taxes – city, county, school, special districts, and state – except for bonded debt, and expansion of sales tax by eliminating many exemptions on current taxation of tangible goods and expanding the sales tax to all services. This policy brief examines some of the implications for tax administration in Georgia; specifically, we focus on local property tax administration and state sales tax administration. This policy brief is one of several that the Fiscal Research Center is preparing on tax policy issues.

### Local Property Tax Administration

The GREAT Plan proposes to eliminate all property taxes in Georgia except those levied to support current bonded debt.\* In 2006, 58 separate jurisdictions in 41 different Georgia counties levied property taxes to retire bonded debt. (Georgia Department of Revenue - Local Government Services Division, 2006) The total levy for bonded debt retirement in these jurisdictions in 2006 was a little over \$341 million. The governments of the counties in which these taxing jurisdictions are located will need to keep their tax assessment and tax collection operations

until all debt is retired. There is no reason to believe they can spend substantially less on these operations, even if the amount levied will be substantially less with the elimination of city, county, district, and school board operating levies. In 2005, these counties spent a combined total of over \$98 million on property tax assessment and collection operations. (Georgia Department of Community Affairs, 2005) These expenditures represent nearly 29 percent of the tax levy. Taxpayers in the other 118 counties would not face similar costs.

### State Sales Tax Administration

The GREAT Plan proposes to expand the sales tax base by eliminating many of the present exemptions and introducing sales tax on all services. Expansion of the sales tax base, especially addition of services to the base, has long been advocated by economists. However, including services will create additional work and burdens for the state's sales tax administrators and vendors (because they act as collectors), complicate compliance, increase the state's administrative costs and collection costs for many vendors, and raise substantive legal questions. As the Georgia Department of Revenue not only collects the state's 4 percent sales tax, but also collects and

distributes the many local option sales taxes, the department will face much greater increases in work and complexity than if it were administering only the 4 percent tax without having to account for county, city, and school district local sales taxes. This section reviews experience in other states, specific administrative issues, and major legal issues that have been raised about sales taxes of services.

*Experience in Other States.* There is scant evidence of the administrative impact of sales tax base expansion in the magnitude of that proposed by the GREAT Plan for Georgia. Very few states tax services extensively. Hawaii and New Mexico have done so since the 1930s when sales taxes were first introduced in the United States. Any lessons that might have been learned from their experience so long ago are not relevant in current times.

Iowa, in 1967, expanded its sales tax base to include 59 enumerated services; there was a 60 percent increase in registered vendors and, eventually, 60 new regulations “produc[ing] more problems than revenue.” (Fox, 1992, p. 31)

In 1986, Florida abolished all sales tax exemptions on services, in effect creating a whole new class of sales taxes very similar to that proposed in the GREAT Plan. Opposition strengthened after adoption, coming from “lawyers and accountants, medical services, auto repairs, dry cleaning and a host of other[s]” including New York advertising agencies. (Levine, 2003) Florida saw an estimated increase of 140,000 vendors (36 percent) and experienced cost increases arising “from hiring and training new auditors, devising new audit selection methods, enhancing computer capacity, and enhancing taxpayer education programs ... 240 positions were added ... to accommodate new administrative demands. In total, \$6 million [\$11 million inflated to 2006] was budgeted for increased administrative costs, which implies incremental costs of \$43 [\$79 inflated to 2006] per additional vendor.” (Fox, 1992) In 1987, Florida repealed the 1986 legislation, restored the sales tax exemptions, and added a penny to its sales tax rate to raise the forgone revenue. (SHD Global; LLC, 2007)

Nebraska considered a sales tax base broadening proposal in 1985 that was as comprehensive as Florida’s expansion. The proposal was eventually withdrawn due to strong opposition. The Nebraska Department of Revenue estimated the proposed 1985 expansion would have increased the number of registered vendors by 23 percent and additional administrative costs to be \$100 (\$193 inflated to 2006) per

additional vendor; a total of \$1.4 million (\$2.7 million inflated to 2006). (Fox, 1992)

*Administrative Issues.* Administration of sales taxes on services, especially if the base is to include all services, not just a few selected services, is not as simple as administration of expansion of sales taxes on tangible goods. Four issues distinguish expansion to sales taxes to services from a simple expansion to additional tangible goods:

- definition of taxable services,
- registration of additional firms,
- inter-state services, and
- the ephemeral nature of services.

Because local governments in Georgia have come to use local option sales taxes so extensively, inter-county tax administration will extend the issues presented for taxation of inter-state services.

There are definitional problems with services themselves: states have had a difficult time defining taxable services, for example: What is a consulting service or a financial service? If pet grooming is taxable, what is a pet? Does use tax apply to a visit to an out-of-state beauty parlor? Likewise, definitions of situs can be difficult: where is a service consumed or used? If a headquarters in Atlanta buys shipping services for a subsidiary in Alabama, is the service consumed in Atlanta or Alabama? Answers are not as straight-forward as they are with tangible goods. (Hamilton and Mikesell, 1992) Definition of situs will probably be more complex and critical if the bases of local sales taxes (LOST, SPLOST, ESPLOST, HOST, MARTA, and Atlanta’s Sewer Sales Tax) are expanded to include services.

When initiating taxes on services an entirely new universe of vendors is brought into the system. This is not so much the case when dealing with consumer services, where often the same vendor sells tangible goods and services. For example, a sales tax is currently imposed on the parts sold by auto repair services. New classes of vendors will include business service, professional service, and health service providers. In Georgia, in the 2002 Economic Census, there were over 67,000 firms classified in business, professional, and health service groups. (U.S. Census Bureau, 2002) Many, if not most, of these firms are likely to be unfamiliar with collecting and reporting sales taxes. Initial education and compliance costs are likely to be high; efforts at evasion may also be high (Alm, 1996), leading to high use of auditing and high auditing costs. Finally, it should not be forgotten that additional sales taxes place additional burdens on vendors; the actual tax collectors. Additional burdens are especially heavy for smaller businesses and businesses engaged in inter-state

commerce facing different tax law and reporting requirements in each different state in which they do business. The more costly it is to comply, the less likely there will be compliance. (Cline and Neubig, 1999)

International, multi-state, inter-state, multi-county, and inter-county taxation of services presents some tough administrative problems. For example, an inter-state (or inter-county) telephone call is a service consumed simultaneously in two or more different states (or counties or nations). Where should it be taxed? Should taxes be apportioned between the different states (or counties or nations)? Who calculates apportionment using whose rules and standards? Who collects and remits payment? How is the tax audited? One interesting solution to this problem is to simply tax the call at the point of billing. Similar questions arise from 1) services produced in Georgia and consumed in many states or even many nations (or produced in, say, Gwinnett County and consumed in every county in Georgia), such as internet services, and 2) services produced elsewhere, but consumed in Georgia (or produced in Fulton County and consumed in Bibb County, or produced in Great Britain and consumed in Savannah) such as architectural services. (Fox, 1992)

The intangible nature of services makes them more difficult to tax than tangible goods. Services tend to be ephemeral; there are no stacks of services on the shelf, no inventory to count, they disappear when consumed and sometimes there is no evidence of consumption. Audits can be very difficult. (Hamilton, and Mikesell, 1992)

**Legal Questions.** Introduction of sales taxes on a broad base of services not only raises objections from those taxed, but may also raise substantial legal issues. Florida faced a variety of fundamental legal issues raised by opponents of its efforts to tax services. Constitutional questions were raised in public debate: 1) does the taxation of legal services burden a person's right to counsel or violate equal protection guarantees? 2) Does taxation of out-of-state sales violate due process and the commerce clause? 3) Does taxation of advertising infringe on the right to free speech? Before any suits were filed, the Florida Supreme Court was asked to issue an advisory opinion on the law's constitutionality. The opinion generally supported the constitutionality of the taxes. The 1987 Florida advisory opinion does not preclude formal challenge in Georgia or in federal courts today. (Fox, 1992)

## Summary

Most economists would support including at least some services in the sales tax base. But, as discussed above,

including services has implications for the administrative effort that has to be made and the number of issues that have to be resolved. These are not insurmountable problems, but they have to be addressed if the sales tax is to function efficiently.

## Note

\*We assume no new property tax backed bonded debt will be permitted after current debt is retired.

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